



Memorandum

JAN 3 1 1994

Date

Michael Mangano

From

June Gibbs Brown
Inspector General

Subject

Audit of Medicare Contractor's Segmented Pension Cost, Blue
Shield of California (A-07-92-00585)

To

Bruce C. Vladeck
Administrator
Health Care Financing Administration

This is to alert you to the issuance on February 1, 1994,
of our final audit report. A copy is attached.

The objective of our audit was to determine whether California Blue Shield (California) complied with the pension segmentation requirements of its Medicare contract. Under its Medicare contract, California was required to identify, allocate, and report pension assets and costs separately for its Medicare segment. This required California to;

- (1) establish a ratio (asset fraction) using the 1981 actuarial liabilities of the segment and the total plan,
- (2) apply the ratio to total pension assets as of 1986,
- (3) update the Medicare segment's 1986 pension assets to later years, and
- (4) assess whether Medicare's pension costs require separate calculations.

Our review disclosed that California correctly determined Medicare segment pension assets of about \$7,050,000 (actuarial value) as of 1986. However, California overstated Medicare's pension assets by \$1,771,445 in updating the Medicare segment assets from 1986 through 1990. California's update excluded certain pension costs, participant transfers and used imprecise and inconsistent methodologies. We also noted that, as of January 1, 1991, California had unfunded pension costs of \$424,403 for the Medicare segment. These costs are unallowable for Medicare reimbursement. The \$424,403 represents pension costs, plus imputed interest not funded within required periods. Finally, our analysis showed a material difference between allocating and separately calculating pension costs for the Medicare segment. When such material differences occur, contractors must separately calculate pension costs for the Medicare segment.

Page 2 - Bruce C. Vladeck

In addition to financial adjustments, we recommended improvements to California's procedures and methodologies for ensuring compliance with the pension segmentation requirements of its Medicare contract. California generally did not concur. However, Health Care Financing Administration regional officials agreed with our findings and recommendations.

Attachment

For further information contact:
Vincent R. Imbriani
Regional Inspector General
for Audit Services, Region VII
(816) 426-3591

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF
MEDICARE CONTRACTOR'S
SEGMENTED PENSION COST,
BLUE SHIELD OF
CALIFORNIA**



JANUARY 1994 A-07-92-00585



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Office of Audit Services

Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

CIN: A-07-92-00585

Mr. Michael Ganahl
Senior Vice President & Chief Financial Officer
Blue Shield of California
P.O. Box 7168
San Francisco, California 94120

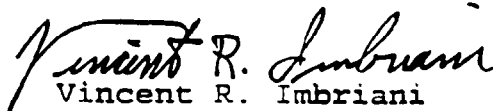
Dear Mr. Ganahl:

Enclosed are two copies of an Office of Inspector General (OIG), Office of Audit Services (OAS) report, "AUDIT OF MEDICARE CONTRACTOR'S PENSION SEGMENTATION, BLUE SHIELD OF CALIFORNIA." Your attention is invited to the findings and recommendations contained in the report. Final determinations as to actions to be taken on all matters reported will be made by the Department of Health and Human Services (HHS) action official identified below. We request that you respond to each of the recommendations in this report within 30 days from the date of this letter to the HHS action official, presenting any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG, OAS reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5.)

To facilitate identification, please refer to the above audit control number in all correspondence relating to this report.

Sincerely,


Vincent R. Imbriani

Regional Inspector General
for Audit Services, Region VII

Enclosure

Action Official:

Mr. Gerald Moskowitz
Regional Administrator, Region IX
Health Care Financing Administration
75 Hawthorne Street, 4th and 5th Floors
San Francisco, California 94105

SUMMARY

Under title XVIII of the Social Security Act, intermediaries and carriers contractually perform Medicare administrative operations. Blue Shield of California (California) has been a carrier for Medicare since the start of the program.

California's Medicare contract requires the separate identification, calculation, and reporting of pension assets, and when appropriate, costs for the Medicare segment. Compliance requires:

- o establishing a ratio (asset fraction) using the 1981 actuarial liabilities of the segment and the total plan,
- o applying the ratio to total pension assets as of 1986,
- o updating the Medicare segment's 1986 pension assets to later years, and
- o assessing if Medicare's pension costs require separate calculations.

California correctly determined Medicare segment pension assets of about \$7,050,000 (actuarial value) as of 1986. However, California overstated Medicare's pension assets by \$1,771,445 in updating the Medicare segment assets from 1986 through 1990. California's update excluded negative Cost Accounting Standards (CAS) pension costs, participant transfers and used imprecise and inconsistent methodologies. We recommend that California reduce assets of the Medicare segment as of 1991 by \$1,771,445. Also, we recommend that California credit Medicare for \$777,656 of negative CAS pension costs.

As of January 1, 1991, California had unfunded pension costs of \$424,403 for the Medicare segment; these costs are unallowable for Medicare reimbursement. The \$424,403 represents pension costs, plus imputed interest, not funded within required periods. We recommend that California separately identify \$424,403 as unallowable for Medicare reimbursement. California needs to continue yearly updates for this unallowable cost and provide similar treatment for any later years' unfunded pension costs.

Finally, our analysis showed a material difference between allocating or separately calculating pension costs for the Medicare segment. When such material differences occur, contractors must separately calculate pension costs for the Medicare segment.

California did not agree with our findings and recommendations.

TABLE OF CONTENTS

	<u>Page</u>
SUMMARY	i
INTRODUCTION	1
BACKGROUND	1
CRITERIA GOVERNING SEGMENTED PENSION COSTS	1
SCOPE OF AUDIT	3
FINDINGS AND RECOMMENDATIONS	5
MEDICARE ASSETS AS OF 1986	5
MEDICARE ASSET BASE	
AS OF 1986 UPDATED TO 1991	5
Negative CAS Pension Costs	5
Participant Transfers	7
Estimates and Inconsistencies	7
Medicare Assets as of January 1, 1991	7
Recommendations	8
Auditee Comments	8
UNFUNDED PENSION COSTS	8
Recommendations	9
Auditee Comments	9
CALCULATION OF MEDICARE PENSION COSTS	10
Recommendation	10
Auditee Comments	10
INSTRUCTIONS FOR AUDITEE RESPONSE	11
APPENDIX A - STATEMENT OF MEDICARE PENSION ASSETS FOR THE PERIOD JANUARY 1, 1986 TO JANUARY 1, 1991	
APPENDIX B - STATEMENT OF CAS PENSION COSTS AND FUNDING FOR THE PERIOD JANUARY 1, 1986 TO JANUARY 1, 1991	
APPENDIX C - STATEMENT OF ACCUMULATED UNFUNDED PENSION COSTS FOR THE PERIOD JANUARY 1, 1986 TO JANUARY 1, 1991	
APPENDIX D - STATEMENT OF FACP CHARGES AND CREDITS FOR THE PERIOD JANUARY 1, 1988 TO JANUARY 1, 1991	
APPENDIX E - AUDITEE'S RESPONSE	

INTRODUCTION

BACKGROUND

Title XVIII of the Social Security Act, Health Insurance Program for the Aged and Disabled (Medicare), provides that organizations may help manage the Medicare program through contracts with the Secretary, Department of Health and Human Services (HHS). Most Medicare contractors, intermediaries (Part A) and carriers (Part B), perform under cost reimbursement contracts renewed annually. California has been a Part B contractor under cost reimbursement contracts since the start of the Medicare program.

Reimbursement principles for cost reimbursement contracts are in the contracts, the Federal Acquisition Regulations (FAR), which superseded the Federal Procurement Regulations (FPR), and the CAS. Medicare contracts provide that a contractor "...shall be paid its costs of administration under the principle of neither profit nor loss...."

In 1985, we issued an audit report, "Medicare Intermediaries and Carriers Should Be Required To Use Segment Accounting For Claiming Pension Costs," (07-52013) to the Health Care Financing Administration (HCFA). The report showed that pension contributions charged to Medicare exceeded the amounts needed to meet Medicare's pension liabilities. The report recommended that HCFA amend Medicare contracts to require treatment of Medicare as a separate segment for calculating and charging pension costs.

The HCFA incorporated segmentation requirements into Medicare contracts starting with Fiscal Year (FY) 1988 and distributed a pension cost questionnaire to contractors in 1989. The purpose of the questionnaire was to ensure that contractors developed and maintained the data necessary for segmentation calculations.

California's questionnaire response of May 14, 1990 showed that all direct Medicare employees were in a dedicated section. The response identified, as of January 1, 1986, Medicare segment assets of \$7.05 million (actuarial value). It did not address allocating or separately calculating pension costs.

CRITERIA GOVERNING SEGMENTED PENSION COSTS

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plans. These payments represent allowable pension costs under the FPR and/or the FAR. In 1980, both the FPR and Medicare contracts incorporated CAS 412 and 413.

The CAS 412 regulates the determination and measurement of pension costs. It also regulates the assignment of pension costs to appropriate accounting periods. The CAS 413 regulates the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

In addition to CAS requirements, HCFA, starting with FY 1988, incorporated segmentation language into Medicare contracts. The language specifies segmentation requirements and also provides for the separate identification of the pension assets for a Medicare segment. California's contract required:

- o computing the Medicare segment's actuarial liability as of 1981,
- o determining the ratio of the Medicare segment's actuarial liability to the total plan's actuarial liability as of 1981,
- o allocating a portion of total pension assets as of 1986 based on the 1981 ratio,
- o updating Medicare pension assets annually, and
- o assessing if Medicare's pension costs should be separately calculated.

The Medicare contracts identify a Medicare segment as:

"The term 'Medicare Segment' shall mean any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/agreement, in which:

1. The majority of the salary dollars is allocated to the Medicare agreement/contract; or
2. Less than a majority of the salary dollars is allocated to the Medicare agreement/contract, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare agreement/contract."

The contracts also provide for separate identification of the pension assets of the Medicare segment. The identification involves the allocation of assets to the Medicare segment as of the first pension plan year after December 31, 1985 in which the

salary criterion was met. The allocation was to use the ratio of the actuarial liabilities of the Medicare segment to the actuarial liabilities of the total plan as of the first day of the first plan year starting after December 31, 1980.

Other CAS requirements apply to the calculation of pension costs. For instance, pension costs for a segment can consider all, or just active, participants (CAS, section 413.50(c)(9)). Also, if they materially affect a segment's ratio of assets to liabilities, transfer adjustments are necessary (CAS, section 413.50(c)(8)). Finally, the CAS addresses allocating or separately calculating pension costs for segments.

SCOPE OF AUDIT

We performed our examination in accordance with generally accepted government auditing standards. Our objective was to determine California's compliance with pension segmentation requirements of its Medicare contract. Achieving our objective did not require a review of California's internal control structure. The audit addressed California's initial determination of pension assets for its Medicare segment and later updates. The audit also addressed CAS and FAR requirements for the development of pension costs. Our review covered January 1, 1981 through January 1, 1991. We identified cumulative negative credits applicable to this period through September 30, 1992.

We reviewed California's identification of the Medicare segment as of January 1, 1988 and traced the organizational lineage of the segment back to 1981. California's actuarial consultants provided plan participants included in the pension plan valuation for each year. An outside contractor that maintains California's human resource data base provided cost center information for plan participants.

We reviewed California's computation of the asset fraction for 1981. California did not provide us liability information by individual. We used analytical procedures as a basis for accepting the Medicare asset fraction. Also, we reviewed the update of Medicare assets from 1986 through 1990. The actuarial consultants provided us information concerning contributions, disbursements, and investment earnings.

In determining the transfer adjustment, the HCFA pension actuarial staff computed the individual participant liabilities for 1986 through 1991. They computed CAS costs under the allocation and the separate valuation method. Also, they developed the update of Medicare assets.

In our review, we also used pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Forms 5500.

Field work was performed from January through November 1992. The field work included site work at California's corporate offices in San Francisco, California.

FINDINGS AND RECOMMENDATIONS

MEDICARE ASSETS AS OF 1986

We accepted California's allocation of 1986 pension assets to the Medicare segment. Medicare's share of pension assets as of January 1, 1986 was \$7,050,000. California computed the asset fraction as follows:

Computation of Medicare Assets as of January 1986

1981 Total Actuarial Liability (A)	1981 Medicare Actuarial Liability (B)	Rounded Asset Fraction (C) (B)÷(A)	1986 Total Company Assets (D)	1986 Medicare Segment Assets (E) (C)x(D)
\$22,424,700	\$4,220,000	18.82 %	\$37,460,800	\$7,050,000 (rounded)

MEDICARE ASSET BASE AS OF 1986 UPDATED TO 1991

California's update of the Medicare asset base to January 1, 1991 overstated Medicare's assets by \$1,771,445. Our revised update considers negative CAS pension costs (\$808,012) and transfers into and out of the Medicare segment (\$860,390). Our update also uses actual data instead of estimates and consistent actuarial methodologies (\$103,043).

Negative CAS Pension Costs

California did not determine the annual Medicare pension cost because of the plan's overfunded condition for tax purposes. The cumulative effect of California not considering negative CAS costs of \$755,552 in its update was an overstatement in the assets of the Medicare segment of \$808,012 as of January 1, 1991.

The Medicare segment, along with the total plan, was overfunded for 1988 through 1990. As a result, there were negative CAS pension costs for each of those years for the Medicare segment. Amortization credits associated with the gains creating the overfunding exceeded the normal cost and amortization charges.

The CAS 412 within 48 CFR 30.412-40(a) states:

"...components of pension costs for a cost accounting period are (i) the normal costs of the period, (ii) a part of any unfunded actuarial liability, (iii) an interest equivalent on the unamortized portion of any

unfunded actuarial liability, and (iv), an adjustment for any actuarial gains and losses."

We computed CAS costs for 1988, 1989, and 1990 including a net credit for the amortization of the unfunded actuarial liability. Since the net credit, including interest equivalents, exceeded the normal cost each year, there were negative CAS costs for 1988 (\$239,689), 1989 (\$263,712) and 1990 (\$252,151). (See Appendix B for more details.)

A negative CAS pension cost represents a release of assets previously applied to a portion of the actuarial liability. The released assets, however, remain in the pension fund. Withdrawals are not permitted under the Employees Retirement Income Security Act of 1974 (ERISA). The released assets represent an inurement to a contractor of previously assigned pension costs. The FAR 31.201-5 requires a credit of such inurements to the Government.

Assets released by negative CAS pension costs represent prepayments if the Medicare segment receives proper credits on the Final Administrative Cost Reports (FACPs). Assigning negative CAS pension costs to the Medicare contract by crediting the FACP and the asset update reverses previous reimbursements of the assets.

We consider released assets as a prepaid, unassigned asset available to fund CAS pension costs (charges) in current or future accounting periods. Therefore, our computations assume an allocation of the credits to the FACP and use the prepayments to fund the CAS pension costs of the nonsegment. The net amounts credited to FACPs were \$222,667 for 1988, \$246,817 for 1989, and \$153,015 for 1990. (See Appendix D for more details.)

California did not credit FACPs for the negative CAS pension costs less the nonsegment charges. As a result, the credits remained in the trust fund as assets drawing interest for Medicare. Until Medicare receives the proper credits, the cumulative negative credits will continue to grow. The following table shows the growth of the credits for each year using the assumed interest rate (8 percent) of the pension plan.

Negative Credits and Interest

<u>Date</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>Total</u>
1-01-89	\$222,667	\$ -0-	\$ -0-	\$222,667
1-01-90	240,480	246,817	-0-	487,297
1-01-91	259,718	266,562	153,015	679,295
1-01-92	280,495	287,887	165,256	733,638
9-30-92	297,325	305,160	175,171	777,656

Participant Transfers

California did not adjust for participant transfers into and out of the Medicare segment after 1986. This resulted in California overstating the Medicare assets by \$860,390.

The CAS requires adjustments if transfers are large enough to cause a distortion of a segment's ratio of fund assets to actuarial liabilities (CAS, section 413.50(c)(8)). California did not perform any analysis to determine if such distortions were occurring. The HCFA actuaries calculated negative transfer adjustments for 1986 (\$115,124), 1987 (\$4,385), 1988 (\$452,733), 1989 (\$184,877), and a positive transfer adjustment for 1990 (\$15,957). (See Appendix A for more details.) The following table illustrates the effect of considering or disregarding transfer adjustments as of 1991.

Transfer Distortion

<u>Description</u>	<u>Assets</u> (A)	<u>Liabilities</u> (B)	<u>Funding Level</u> (A)/(B)
Considered	\$ 9,368,713	\$ 6,678,878	140.3%
Not Considered	<u>10,229,103</u>	<u>6,678,878</u>	<u>153.2%</u>
Difference	<u>\$ 860,390</u>	<u>-0-</u>	<u>12.9%</u>

Percentage Difference for the Funding Level 9.2%

Both the dollar amount (\$860,390) and the funding level percentage (9.2 percent) differences represent a significant distortion. California should have adjusted for transfers in updating the Medicare segment assets.

Estimates and Inconsistencies

In the asset update, California used estimated benefit payments. We used the actual benefit payments. California also used a different method for determining the actuarial value of Medicare assets than was used in their actuarial report for the total plan. For consistency, we used California's actuarial method for their total plan in our Medicare asset update shown in Appendix A. The result was a net decrease of \$103,043 in Medicare segment assets.

Medicare Assets as of January 1, 1991

Our update, in relation to California's update, decreased assets of the Medicare segment by \$1,771,445 as of January 1, 1991. The reduction reflects negative CAS pension costs (\$808,012), transfer adjustments (\$860,390), and adjustments for estimates and inconsistent data (\$103,043).

Recommendations:

We recommend that California:

- o Decrease the Medicare segment assets by \$1,771,445 as of January 1, 1991.
- o Credit Medicare on FACP's for the negative CAS pension costs plus interest for 1988, 1989, and 1990. The total amount is \$777,656 as of September 30, 1992.
- o Assign FACP credits when there are negative CAS pension costs and track the application of the associated prepayments.
- o Make periodic transfer adjustments as needed.
- o Update Medicare assets using actual data and consistent methodologies.

Auditee Comments

"In response to the subject draft audit report, we do not concur with the finding regarding 'Unfunded Pension Costs.' Given the impact of this item on major calculations within the report, we will address these along with the 'Unfunded Pension Costs' issue in future discussions with HCFA."

UNFUNDED PENSION COSTS

As of 1991, California accumulated \$424,403 in unallowable direct pension costs related to the Medicare segment. Funding of the pension costs did not occur within required periods. The \$424,403 represents unfunded costs of \$322,585 and imputed interest of \$101,818, also unallowable, involving 1986 to 1991.

The FAR, 48 CFR 31.205-6(j)(3)(i) and (iii), states:

"...costs of pension plans not funded in the year incurred, and all other components of pension costs...assignable to the current accounting period but not funded during it, shall not be allowable in subsequent years...."

"Increased pension costs caused by delay in funding beyond 30 days after each quarter of the year to which they are assignable are unallowable."

Furthermore, the CAS within 48 CFR 30.412-50(a)(7) states:

"If any portion of the pension costs computed for a cost accounting period is not funded in that period, no amount for interest on the portion not funded in that period shall be a component of pension cost of any future cost accounting period."

In addition, the CAS within 48 CFR 30.412-50(a)(2) states:

"Pension costs applicable to prior years that were specifically unallowable in accordance with then existing Government contractual provisions shall be separately identified and eliminated from any unfunded actuarial liability being amortized...."

The following table shows the unfunded costs and unallowable interest on a cumulative basis. The assets of the Medicare segment would have been greater by the amounts shown at the specified periods if funding had taken place. (See Appendices B and C for more details.)

Unfunded Pension Costs and Interest

<u>Date</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>Total</u>
1/1/87	\$179,005	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$179,005
1/1/88	193,325	143,580	-0-	-0-	-0-	336,905
1/1/89	208,791	155,066	-0-	-0-	-0-	363,857
1/1/90	225,494	167,471	-0-	-0-	-0-	392,965
1/1/91	243,534	180,869	-0-	-0-	-0-	424,403

Recommendations

We recommend that California:

- o Identify \$424,403 as an unallowable component of direct pension costs as of 1991.
- o Update annually the unallowable pension cost component related to the unfunded CAS costs for 1986 through 1990.
- o Identify and track unfunded pension costs occurring in later years.

Auditee Comments

"In response to the subject draft audit report, we do not concur with the finding regarding 'Unfunded Pension Costs.' Given the impact of this item on major calculations within the report, we will address these along with the 'Unfunded Pension Costs' issue in future discussions with HCFA."

CALCULATION OF MEDICARE PENSION COSTS

Medicare contracts allow allocations of funded pension costs to Medicare if such amounts do not materially differ from separate calculations. If material differences exist, separate calculations are required. Due to the absence of contributions to the plan during the audit period, neither California or its actuarial firm determined if there were material differences.

We computed pension costs for the Medicare segment for 1988 through 1990 using allocations and separate calculations. As shown in the following schedule, the costs separately calculated are materially different in dollar amounts and as a percentage of cost.

<u>Annual CAS Pension Costs</u>			
<u>Method</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>
Allocation	\$189,768	\$221,898	\$270,010
Separate Calculation	<u>(221,934)</u>	<u>(244,178)</u>	<u>(233,473)</u>
Difference	\$411,702	\$466,076	\$503,483
Percentage	217 %	210 %	187 %

Recommendation:

We recommend that California:

- o Ensure that separate calculations of pension costs are made when material differences result between allocation and separate calculation of the pension costs charged to Medicare.

Auditee Comments

"In response to the subject draft audit report, we do not concur with the finding regarding 'Unfunded Pension Costs.' Given the impact of this item on major calculations within the report, we will address these along with the 'Unfunded Pension Costs' issue in future discussions with HCFA."

INSTRUCTIONS FOR AUDITEE RESPONSE

Final determinations as to actions to be taken on all matters reported will be made by the HHS action official identified below. We request that you respond to each of the recommendations in this report within 30 days from the date of this letter to the HHS action official, presenting any comments or additional information that you believe may have a bearing on the final determination.

- - - - -

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG, OAS reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5.)

HHS Action Official:

Mr. Gerald Moskowitz
Regional Administrator, Region IX
Health Care Financing Administration
75 Hawthorne Street, 4th and 5th Floors
San Francisco, California 94105

APPENDICES

BLUE SHIELD OF CALIFORNIA
SAN FRANCISCO, CALIFORNIA

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD
JANUARY 1, 1986 TO JANUARY 1, 1991

		<u>Total Plan</u>	<u>Other Segments 1/</u>	<u>Medicare Segment</u>
01/01/86 Market Value of Assets	2/	\$41,897,494	\$34,012,386	\$7,885,108
Contributions	3/	0	0	0
Benefits	4/	(1,926,943)	(1,724,382)	(202,561)
Expenses	5/	0	0	0
Investment Earnings	5/	3,553,646	2,877,901	675,745
Appreciation	5/	3,681,131	2,981,144	699,987
Net Transfers	6/	0	115,124	(115,124)
01/01/87 Market Value of Assets		47,205,328	38,262,173	8,943,155
Deferred Appreciation	7/	(5,924,382)	(4,803,655)	(1,120,727)
01/01/87 Actuarial Value of Assets		\$41,280,946	\$33,458,518	\$7,822,428
01/01/87 Market Value of Assets		\$47,205,328	\$38,262,173	\$8,943,155
Contributions		0	0	0
Benefits		(1,674,946)	(1,549,132)	(125,814)
Expenses		(225)	(182)	(43)
Investment Earnings		3,618,811	2,925,746	693,065
Depreciation		(3,093,695)	(2,501,199)	(592,496)
Net Transfers		0	4,385	(4,385)
01/01/88 Market Value of Assets		46,055,273	37,141,791	8,913,482
Deferred Appreciation		(1,639,853)	(1,335,124)	(304,729)
01/01/88 Actuarial Value of Assets		\$44,415,420	\$35,806,667	\$8,608,753
01/01/88 Market Value of Assets		\$46,055,273	\$37,141,791	\$8,913,482
Contributions	8/	0	239,689	(239,689)
Benefits		(1,497,690)	(1,333,306)	(164,384)
Expenses		0	0	0
Investment Earnings		3,828,510	3,082,243	746,267
Appreciation		903,815	727,640	176,175
Net Transfers		0	452,733	(452,733)
01/01/89 Market Value of Assets		49,289,908	40,310,790	8,979,118
Deferred Appreciation		(1,282,575)	(1,039,611)	(242,964)
01/01/89 Actuarial Value of Assets		\$48,007,333	\$39,271,179	\$8,736,154

BLUE SHIELD OF CALIFORNIA
SAN FRANCISCO, CALIFORNIA

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD
JANUARY 1, 1986 TO JANUARY 1, 1991

	<u>Total Plan</u>	<u>Other Segments</u>	<u>Medicare Segment</u>
01/01/89 Market Value of Assets	\$49,289,908	\$40,310,790	\$8,979,118
Contributions	0	263,712	(263,712)
Benefits	(2,457,113)	(2,307,040)	(150,073)
Expenses	0	0	0
Investment Earnings	3,669,827	2,989,937	679,890
Appreciation	4,112,152	3,350,315	761,837
Net Transfers	<u>0</u>	<u>184,877</u>	<u>(184,877)</u>
01/01/90 Market Value of Assets	54,614,774	44,792,591	9,822,183
Deferred Appreciation	<u>(3,330,759)</u>	<u>(2,712,585)</u>	<u>(618,174)</u>
01/01/90 Actuarial Value of Assets	\$51,284,015	\$42,080,006	\$9,204,009
01/01/90 Market Value of Assets	\$54,614,774	\$44,792,591	\$9,822,183
Contributions 2/	2,153,788	2,405,939	(252,151)
Benefits	(2,877,196)	(2,605,354)	(271,842)
Expenses	0	0	0
Investment Earnings	3,339,893	2,731,518	608,375
Depreciation	(3,972,885)	(3,249,207)	(723,678)
Net Transfers	<u>0</u>	<u>(15,957)</u>	<u>15,957</u>
01/01/91 Market Value of Assets	53,258,374	44,059,530	9,198,844
Deferred Depreciation	<u>968,230</u>	<u>798,361</u>	<u>169,869</u>
01/01/91 Actuarial Value of Assets	\$54,226,604	\$44,857,891	\$9,368,713
01/01/91 Proposed Value of Assets 10/			<u>\$11,140,158</u>
Difference			<u>\$(1,771,445)</u>

BLUE SHIELD OF CALIFORNIA
SAN FRANCISCO, CALIFORNIA

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD
JANUARY 1, 1986 TO JANUARY 1, 1991

FOOTNOTES

- 1/ We subtracted the Medicare segment figures from total plan amounts to determine amounts for the "Other Segments".
- 2/ The 01/01/86 Market Value of Assets (MVA) for the Medicare segment was established by the audited asset fraction. (See finding in the narrative for more details.) We computed the Medicare MVA by applying the asset fraction (18.82) to the 01/01/81 total company MVA (\$41,897,494.) Except for 01/01/91, we obtained the total company MVA from actuarial valuation reports. We computed the MVA amount for 01/01/91. (See footnote 9/ for more details.)
- 3/ Based on information from the actuarial valuation reports, California made no contributions to the trust fund for the period 1986 through 1989. We computed the contribution amount for 1990. (See footnote 9/ for more details.)
- 4/ We obtained total benefit amounts from actuarial valuation reports. Medicare segment benefit payments were calculated using actual benefits paid to Medicare segment participants.
- 5/ We obtained total plan expenses, investment earnings, and appreciation (depreciation) from actuarial valuation reports. California allocated these total plan items based on the ratio of Medicare segment to total plan beginning of year Actuarial Value of Assets (AVA) minus one half of the benefit payments. We used the same methodology, except our proportion was based on the MVA because investment expenses, earnings, and appreciation are attributable to the amount invested. This is consistent with the development of the AVA for the total plan. (See footnote 7/ for more details.)
- 6/ We identified participant transfers between segments by comparing participant data files provided by the Wyatt Company, California's actuarial firm. The actuarial liabilities of the participant transfers were calculated by HCFA Office of the Actuary. We transferred assets equal to participant's actuarial liability. (See finding in narrative for more detail.)
- 7/ For the total plan, recognition of each year's appreciation (depreciation) is spread over 5 years. This is the AVA method used by the Wyatt Company. The annual appreciation gain for the Medicare segment for 1986 and subsequent years was identified as described in footnote 5/. For years prior to 1986, a portion of the annual appreciation for the total plan was allocated to the segment based on the asset fraction.
- 8/ Our separate computations of pension costs showed a negative Cost Accounting Standards (CAS) cost for the Medicare segment for 1988, 1989, and 1990. Assets are released by these negative CAS pension costs and can be used for funding the CAS pension costs separately developed for the "Other Segments." (See Appendix B, footnote 6/ for more details.)

BLUE SHIELD OF CALIFORNIA
SAN FRANCISCO, CALIFORNIA

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD
JANUARY 1, 1986 TO JANUARY 1, 1991

FOOTNOTES

- 9/ California included no contributions on their update of assets for plan year 1990, even though for ERISA funding purposes they claimed \$2,381,039, deposited in 1991, on their 1990 IRS Form 5500, Schedule B. We recognized \$2,153,788 of California's 9/6/91 contribution (\$2,221,903) for CAS purposes since this deposit was made within the tax filing deadline. All the remaining 1991 deposits, or portion thereof, not used for funding 1990 CAS pension costs are available for funding 1991 costs. The contribution amounts represent the 12/31/90 required funding computed on Appendix B.
- 10/ The Wyatt Company provided an asset schedule that listed the 01/01/91 proposed AVA for the Medicare segment.

BLUE SHIELD OF CALIFORNIA
SAN FRANCISCO, CALIFORNIA

STATEMENT OF CAS PENSION COSTS AND FUNDING

FOR THE PERIOD
JANUARY 1, 1986 TO JANUARY 1, 1991

		<u>Total Plan</u>	<u>Other Segments</u>	<u>Medicare Segment</u>
01/01/86 Amortization Payment	<u>1/</u>	\$ (576,693)	-	-
Normal Cost	<u>2/</u>	<u>1,460,300</u>	-	-
01/01/86 CAS Pension Cost	<u>3/</u>	883,607	\$717,862	\$165,745
Interest to 12/31/86	<u>4/</u>	<u>70,689</u>	<u>57,429</u>	<u>13,260</u>
12/31/86 Required Funding	<u>5/</u>	954,296	775,291	179,005
Released Assets	<u>6/</u>	0	0	0
Contribution	<u>7/</u>	<u>0</u>	<u>0</u>	<u>0</u>
12/31/86 Unfunded Pension Cost	<u>8/</u>	\$ 954,296	\$775,291	\$179,005
01/01/87 Amortization Payment		\$ (833,024)	-	-
Normal Cost		<u>1,634,900</u>	-	-
01/01/87 CAS Pension Cost		801,876	668,932	132,944
Interest to 12/31/87		<u>64,150</u>	<u>53,514</u>	<u>10,636</u>
12/31/87 Required Funding		866,026	722,446	143,580
Released Assets		0	0	0
Contribution		<u>0</u>	<u>0</u>	<u>0</u>
12/31/87 Unfunded Pension Cost		\$ 866,026	\$722,446	\$143,580
01/01/88 Amortization Payment	<u>9/</u>	\$ (727,123)	\$ (255,997)	\$(471,126)
Normal Cost	<u>10/</u>	<u>1,931,800</u>	<u>1,682,608</u>	<u>249,192</u>
01/01/88 CAS Pension Cost		1,204,677	1,426,611	(221,934)
Interest to 12/31/88		<u>96,374</u>	<u>114,129</u>	<u>(17,755)</u>
12/31/88 Required Funding		1,301,051	1,540,740	(239,689)
Released Assets		0	(239,689)	239,689
Contribution		<u>0</u>	<u>0</u>	<u>0</u>
12/31/88 Unfunded Pension Cost		\$1,301,051	\$1,301,051	\$ 0

BLUE SHIELD OF CALIFORNIA
SAN FRANCISCO, CALIFORNIA

STATEMENT OF CAS PENSION COSTS AND FUNDING

FOR THE PERIOD
JANUARY 1, 1986 TO JANUARY 1, 1991

	<u>Total Plan</u>	<u>Other Segments</u>	<u>Medicare Segment</u>
01/01/89 Amortization Payment	\$ (803,086)	\$ (299,520)	\$ (503,566)
Normal Cost	<u>2,393,000</u>	<u>2,133,612</u>	<u>259,388</u>
01/01/89 CAS Pension Cost	1,589,914	1,834,092	(244,178)
Interest to 12/31/89	<u>127,193</u>	<u>146,727</u>	<u>(19,534)</u>
12/31/89 Required Funding	1,717,107	1,980,819	(263,712)
Released Assets	0	(263,712)	263,712
Contribution	<u>0</u>	<u>0</u>	<u>0</u>
12/31/89 Unfunded Pension Cost	\$1,717,107	\$1,717,107	\$ 0
01/01/90 Amortization Payment	\$ (883,752)	\$ (350,543)	\$ (533,209)
Normal Cost	<u>2,878,000</u>	<u>2,578,264</u>	<u>299,736</u>
01/01/90 CAS Pension Cost	1,994,248	2,227,721	(233,473)
Interest to 12/31/90	<u>159,540</u>	<u>178,218</u>	<u>(18,678)</u>
12/31/90 Required Funding	2,153,788	2,405,939	(252,151)
Released Assets	0	(252,151)	252,151
Contribution <u>11/</u>	<u>(2,153,788)</u>	<u>(2,153,788)</u>	<u>0</u>
12/31/90 Unfunded Pension Cost	\$ 0	\$ 0	\$ 0

BLUE SHIELD OF CALIFORNIA
SAN FRANCISCO, CALIFORNIA

STATEMENT OF CAS PENSION COSTS AND FUNDING

FOR THE PERIOD
JANUARY 1, 1986 TO JANUARY 1, 1991

FOOTNOTES

- 1/ The CAS amortization schedule shows the net amount of payments and credits. The HCFA Office of the Actuary developed the CAS amortization schedule based upon information in the actuarial valuation reports. Unlike ERISA, the amortization of unfunded actuarial liabilities (UAL) continues uninterrupted even when an actuarial surplus (a negative UAL) occurs. For purposes of establishing the CAS amortization schedule, we deemed the 01/01/86 ERISA "credit balance" an experience gain, amortizing it over 15 years.
- 2/ We obtained the normal cost for the total plan from the actuarial valuation reports.
- 3/ The sum of the amortization payment and the normal cost. We allocated the CAS pension costs based on participant salaries for 1986 and 1987. We separately calculated CAS pension costs for the Medicare segment for the remaining years.
- 4/ We applied 1 year's interest at the assumed rate of 8 percent to the CAS pension cost. We obtained the interest rate from the actuarial valuation reports.
- 5/ The annual CAS pension cost, adjusted with interest to the end of the year, must be funded by current and prepaid contributions to satisfy the allowability criteria of FAR, section 31.205-6(j).

BLUE SHIELD OF CALIFORNIA
SAN FRANCISCO, CALIFORNIA

STATEMENT OF CAS PENSION COSTS AND FUNDING

FOR THE PERIOD
JANUARY 1, 1986 TO JANUARY 1, 1991

FOOTNOTES

- 6/ Our separate computations of pension costs showed negative CAS costs for the Medicare segment for 1988 through 1990. A negative CAS pension cost occurs whenever the sum of the amortization credits exceeds the sum of amortization charges plus the normal cost. Such a situation will usually occur following a period of excessive or repetitive actuarial gains and will often be associated with a fully funded plan.

The negative CAS pension cost represents a release of assets that had previously been applied towards a portion of the actuarial liability. Once the negative CAS pension costs are allocated to the Medicare contract by a credit on the FACP, the released assets become unassigned contractor assets available to fund other current or future period CAS pension costs.

- 7/ California made no contributions to the trust fund for the years 1986 through 1989. (See Appendix A, footnotes 3/ and 8/, for more details.)
- 8/ The required funding, including interest, minus any contributions and released assets.
- 9/ We combined existing total plan amortization charge and credit bases, maintained for ERISA purposes, using IRS (ERISA) Proposed Regulation 1.412(b)-1 methodology. We created a separate CAS amortization schedule for the segment from the total plan schedule. We used the IRS (ERISA) rules which govern the allocation of amortization bases and credit balances in a plan spin-off as authoritative guidance in establishing the segment's CAS amortization schedule. (See IRS Revenue Rulings 81-212, 86-47, and 86-48.)
- 10/ The HCFA Office of the Actuary estimated the Medicare segment's normal cost beginning in 1988. That office based the estimate upon participant data obtained from California's actuarial firm.

BLUE SHIELD OF CALIFORNIA
SAN FRANCISCO, CALIFORNIA

STATEMENT OF CAS PENSION COSTS AND FUNDING

FOR THE PERIOD
JANUARY 1, 1986 TO JANUARY 1, 1991

FOOTNOTES

- 11/ California made two contributions to the trust fund for plan year 1990. We recognized the contributions necessary to meet the 12/30/90 required funding. (See Appendix A, footnote 9/ for more details.)

BLUE SHIELD OF CALIFORNIA
SAN FRANCISCO, CALIFORNIA

STATEMENT OF ACCUMULATED UNFUNDED PENSION COSTS

FOR THE PERIOD
JANUARY 1, 1986 TO JANUARY 1, 1991

		<u>Total Plan</u>	<u>Other Segments</u>	<u>Medicare Segment</u>
01/01/86 Accumulated Unfunded Pension Costs		\$ 0	\$ 0	\$ 0
Interest to 12/31/86	1/	0	0	0
12/31/86 Unfunded Pension Cost	2/	<u>954,296</u>	<u>775,291</u>	<u>179,005</u>
01/01/87 Accumulated Unfunded Pension Costs	3/	\$ 954,296	\$775,291	\$179,005
Interest to 12/31/87		76,344	62,024	14,320
12/31/87 Unfunded Pension Cost		<u>866,026</u>	<u>722,446</u>	<u>143,580</u>
01/01/88 Accumulated Unfunded Pension Costs		\$1,896,666	\$1,559,761	\$336,905
Interest to 12/31/88		151,733	124,781	26,952
12/31/88 Unfunded Pension Cost		<u>1,301,051</u>	<u>1,301,051</u>	<u>0</u>
01/01/89 Accumulated Unfunded Pension Costs		\$3,349,450	\$2,985,593	\$363,857
Interest to 12/31/89		267,956	238,847	29,109
12/31/89 Unfunded Pension Cost		<u>1,717,107</u>	<u>1,717,107</u>	<u>0</u>
01/01/90 Accumulated Unfunded Pension Costs		\$5,334,513	\$4,941,547	\$392,966
Interest to 12/31/90		426,761	395,324	31,437
12/31/90 Unfunded Pension Cost		<u>0</u>	<u>0</u>	<u>0</u>
01/01/91 Accumulated Unfunded Pension Costs		\$5,761,274	\$5,336,871	\$424,403

BLUE SHIELD OF CALIFORNIA
SAN FRANCISCO, CALIFORNIA

STATEMENT OF ACCUMULATED UNFUNDED PENSION COSTS

FOR THE PERIOD
JANUARY 1, 1986 TO JANUARY 1, 1991

FOOTNOTES

- 1/ We applied 1 year's interest at the assumed rate of 8 percent to the accumulated unfunded pension cost. We obtained the interest rate from the actuarial valuation reports.
- 2/ We developed the unfunded pension cost on Appendix B.
- 3/ The sum of prior year's accumulated unfunded pension costs, interest, and current year's unfunded pension cost.

BLUE SHIELD OF CALIFORNIA
SAN FRANCISCO, CALIFORNIA

STATEMENT OF FACP CHARGES AND CREDITS

FOR THE PERIOD
JANUARY 1, 1988 TO JANUARY 1, 1991

		<u>Total Plan</u>	<u>Other Segments</u>	<u>Medicare Segment</u>
-	Contribution Deposit	1/ \$ 0	\$ 0	\$ 0
12/31/88	Released Assets	2/ <u>0</u>	<u>239,689</u>	<u>(239,689)</u>
	Total Funding	3/ 0	239,689	(239,689)
	Discount to 01/01/88	4/ <u>0</u>	<u>(17,755)</u>	<u>17,755</u>
01/01/88	Present Funding Value	5/ 0	221,934	(221,934)
	Allowable Interest	6/ <u>0</u>	<u>12,576</u>	<u>(12,576)</u>
	Allocable to FACP	7/ 0	234,510	(234,510)
	Medicare LOB Percentage	8/ <u>5.05%</u>	<u>100.00%</u>	<u>100.00%</u>
12/31/88	Charge (Credit) to FACP	9/ \$(222,667)	\$ 11,843	\$(234,510)
-	Contribution Deposit	\$ 0	\$ 0	\$ 0
12/31/89	Released Assets	<u>0</u>	<u>263,712</u>	<u>(263,712)</u>
	Total Funding	0	263,712	(263,712)
	Discount to 01/01/89	<u>0</u>	<u>(19,534)</u>	<u>19,534</u>
01/01/89	Present Funding Value	0	244,178	(244,178)
	Allowable Interest	<u>0</u>	<u>13,837</u>	<u>(13,837)</u>
	Allowable Pension Cost	0	258,015	(258,015)
	Medicare LOB Percentage	<u>4.34%</u>	<u>100.00%</u>	<u>100.00%</u>
12/31/89	Charge (Credit) to FACP	\$(246,817)	\$ 11,198	\$(258,015)
12/31/90	Released Assets	\$ 0	\$ 252,151	\$(252,151)
09/06/91	Contribution Deposit	10/ <u>2,153,788</u>	<u>2,153,788</u>	<u>0</u>
	Total Funding	2,153,788	2,405,939	(252,151)
	Discount to 01/01/90	<u>(159,540)</u>	<u>(178,218)</u>	<u>18,678</u>
01/01/90	Present Funding Value	1,994,248	2,227,721	(233,473)
	Allowable Interest	<u>113,007</u>	<u>126,237</u>	<u>(13,230)</u>
	Allowable Pension Cost	2,107,255	2,353,958	(246,703)
	Medicare LOB Percentage	<u>3.98%</u>	<u>100.00%</u>	<u>100.00%</u>
12/31/90	Charge (Credit) to FACP	\$ (153,015)	\$ 93,688	\$(246,703)

BLUE SHIELD OF CALIFORNIA
SAN FRANCISCO, CALIFORNIA

STATEMENT OF FACP CHARGES AND CREDITS

FOR THE PERIOD
JANUARY 1, 1988 TO JANUARY 1, 1991

FOOTNOTES

- 1/ California made no contributions to the trust fund for plan years 1988 and 1989.
- 2/ Assets released by negative CAS pension costs can be used for funding the CAS pension costs separately developed for "Other Segments." We valued the released assets as of the end of the plan year. (See Appendix B, footnote 6 for more details.)
- 3/ Sum of contributions plus released assets.
- 4/ We discounted contributions from the date of deposit, and released assets from the end to the beginning of the calendar year, at the assumed interest rate of 8 percent. We considered contributions deposited to the trust fund after the end of the plan year, but within the tax-filing deadline, to have been deposited on December 31 of the plan year.
- 5/ Actual contributions and released assets minus the discount to January 1. This is the present value of contributions and released assets as of January 1.
- 6/ Section 31.205-6(j)(3)(iii) of the FAR allows an adjustment for interest costs if the CAS pension cost is funded in 4 installments each paid within 30 days after the end of each quarter. We computed the maximum allowable interest adjustment using the assumed interest rate of 8 percent.
- 7/ Sum of the Present Value of Funding plus Allowable Interest. This allowable pension cost is the gross amount that is allocated to cost centers for ultimate allocation to the FACP based on Line of Business (LOB) percentages.
- 8/ We computed the LOB percentages for the Medicare segment and for the "Other Segments" based on California's cost center expense summary report.
- 9/ Allowable Pension Cost applied to the Medicare LOB percentage.
- 10/ We recognized \$2,153,788 of California's 9/6/91 contribution. (See Appendix A, footnote 9/, for more details.)



BLUE SHIELD
of California

BLUE SHIELD PLAZA TWO NORTH POINT SAN FRANCISCO CA
Mailing Address P.O. Box 7168, San Francisco, CA 94120

July 30, 1993

Mr. Vincent R. Imbriani
Department of Health & Human Services
Office of Inspector General
Office of Audit Services
Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

Re: CIN: A-07-92-00585 dated March 22, 1993

Dear Mr. Imbriani:

In response to the subject draft audit report, we do not concur with the finding regarding "Unfunded Pension Costs". Given the impact of this item on major calculations within the report, we will address these along with the "Unfunded Pension Costs" issue in future discussions with HCFA.

Respectfully,

Michael Ganahl
Vice President and Chief Financial Officer

cc: Mr. Jim Aasmundstad, OIG, OAS

RECEIVED
OIG/OAS-REGION VII

1993 JUL 33 AM 10:16

CALIFORNIA PHYSICIANS' SERVICE

A Statewide Health Care Service Plan